H-3107-1 - CONTINUATION, EXTENSION, OR RENEWAL OF LEASES

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1. Compare the allowable operating costs to gross income on a monthly basis.

   a. If such comparison shows the lease is not profitable for a month, determine whether production is exhausted or is temporarily shut in for mechanical repairs. If production is exhausted, i.e., the lease is no longer capable of production in paying quantities, then the lease terminated. If the shut in was for mechanical repairs, the lease will not terminate if operations are diligently commenced and continued until the well is returned to paying production.

   b. If such comparison shows the lease is profitable, then no further action needs to be taken.

2. Compare total yearly cost (calendar year, lease year, or latest 12-month period) to total yearly income. This includes the cost of rental/minimum royalty plus the prorated cost of routine workovers.

   a. If such comparison shows the lease is still profitable, then no further action needs to be taken.

   b. If such comparison shows the lease is not profitable, then paying production will be considered exhausted and the lease terminated, unless the lessee or operator diligently performs any necessary repair work in attempting to improve the well's producing capabilities.

The following example illustrates the above procedures:

Month	Direct Operating Cost ($)	Value Oil & Gas ($)	Net ($)
Jan.	150	110	(40)
Feb.	150	175	25
⌊	⌊	⌊	⌊
Nov.	150	175	25
Dec.	150	110	(40)
Year Total	$1,800	$1,970	$170

Accordingly, if the total of any additional rental/minimum royalty obligations is less the $170, the lease is capable of production in paying quantities.

3. The following leases are subject to analysis:

   a. Any lease whose monthly operating costs appear to exceed monthly income for 2 consecutive months.

   b. Any lease entering its extended term by production.

   c. Any lease where the monthly report shows zero production.